

15 August 2019

Local Government Funding and Financing Draft Report
Productivity Commission
Private Bag
WELLINGTON

Email: info@productivity.govt.nz

Dear Sir

Introduction

1. This submission is made by Water New Zealand on the report – Local Government Funding and Financing.
2. Water New Zealand is a national not-for-profit sector organisation comprising approximately 2000 corporate and individual members in New Zealand and overseas. Water New Zealand is the principal voice for the water sector, focusing on the sustainable management and promotion of the water environment and encompassing the three waters: drinking water, waste and storm waters.

Commission's Findings and Recommendations

3. Water New Zealand is broadly supportive of the analysis, findings and recommendations of the Commission in relation to this Inquiry, in particular those related to the administration of 3 waters by Local Government. There is however one element of the report with which we do not agree, that to do with a permissive approach by Councils to meeting 3 waters regulatory objectives - and we have provided some commentary on that matter below.

Trends in Local Government Expenditure, Prices and Debt

4. Figure 3.6 on page 54 indicates that analysis of Council Long Term Plans shows a trend of capital expenditure tapering off over the next 10 years. This is surprising, given that work done by BECA for DIA on upgrading water supplies, and GHD/Boffa Miskell for DIA on upgrading waste-water supplies, indicates that several billion dollars of investment is required to meet the current standards. The Commission identifies these costs on page 65 of its report.
5. Work done by LGNZ in the past 12 months shows that many councils are facing significant costs in the area of responding to climate change impacts. None of the work done by DIA in their 3 waters investigations has factored in expenditure to make more resilient or shift 3 waters infrastructure near the coast likely to be affected by climate change – specifically sea level rise.
6. The analysis which shows that over long periods of time, and with some variation, that increases in local government revenue and rates have roughly matched increases in national and household income – is welcome. This finding is at odds with the often-stated

position from local government that pressure from central government for local government to take on functions are making rates unaffordable. In aggregate that is not the case.

Pressures on Funding and Financing

7. The Commission has found that the cumulative impact of responsibilities passed on to local government have created cost pressures for some councils. This is exacerbated in small rural councils with a declining rating base and aging population.
8. The impacts associated with increasing standards in the area of drinking water, wastewater and stormwater management are likely to increase those pressures. As the Commission has found, increased central government and community expectations over time, combined with the requirement to respond to new initiatives such as climate change and Treaty settlements, is only going to exacerbate the funding pressures in some communities going forward. Alternative approaches are available to deal with those pressures, but it requires leadership from local government to make the changes needed.
9. The strengthening of drinking water standards and the DIA/BECA paper estimate to bring water treatment plants up to meet the current DWSNZ of \$384 million is considered by many in the industry at the low end of the scale, most believe the actual cost will be significantly higher.

Improving Decision Making

10. We generally support the findings and recommendations in this section of the report.
11. We support Recommendation 5.3 in relation to amending the LGA 2002 to mandate the establishment of an audit and risk committee at each council, chaired by an independent person with independent members having appropriate skills and qualifications. This will complement the skill sets of elected councillors.
12. We submit that Recommendation 5.5 should be extended to require greater participation in the benchmarking exercise Water New Zealand undertakes through its National Performance Review into 3 waters administration by councils. There are about 17 of 67 Councils who do not participate, and many that do participate, do so in a limited way. Collecting and reporting data on 3 waters performance is one of the first steps to highlighting areas for improvement.

Future Funding and Financing Arrangements

13. In Recommendation 6.2 the Commission recommends that:
“Councils should prioritise improving their knowledge of the condition and performance of their assets to, among other benefits, avoid the risk of underestimating asset lives and overestimating depreciation expense.”
14. 3 waters asset management is a problem which Water New Zealand has highlighted before. While a new 3 waters regulator may set in place rules to ensure better asset management performance, in the meantime the approach by councils to asset management is quite disparate. For example, there are at least four separate technical manuals (some international) used by councils to undertake pipeline condition assessment – even though

Water New Zealand has a published manual on the topic.

15. Despite the Commissions support for a permissive approach by councils in how they demonstrate compliance, we submit that for a country as small as New Zealand, and with councils consistently stating they have staffing capacity and capability issues, that greater direction as to the use of technical guidance would be of benefit.
16. As the Commission observes in Recommendation 6.6, the Government:
“should favour models capable of applying efficient scale and specialisation to help small communities meet the challenges of maintaining and upgrading their water, wastewater and stormwater infrastructures.”
Water New Zealand supports this recommendation.
17. There are of course other options available to councils to manage financial pressures associated with managing their 3 waters. For example, councils could implement direct charging of customers for water use on a volumetric basis. The evidence from several councils in New Zealand is that this makes transparent the costs associated with the provision of waters service and removes them from rates. It incentivises the identification of and prevention of water leakage, reduces consumption and frequently defers the necessity for investment in new infrastructure.

Adapting to Climate Change

18. Water New Zealand supports most of the findings and recommendations in Chapter 8 related to climate change. In particular, R8.5 related to broadening the role of NZTA to co-fund councils faced with threats from climate change to local land-transport infrastructure seems sensible. That will of course cost more money and require petrol excise and the like to be substantially increased.
19. While R8.6 related to the establishment of a resilience fund has merit, we have reservations about this being a local government-led initiative. The funding to rebuild and relocate 3 waters or roading assets because of sea level rise or flooding will inevitably have to come in large part from central government. It seems more logical that NZTA takes the lead where expenditure relates to roading.
20. Where funding is to come from central government to co-fund council expenditure to make 3 waters infrastructure more resilient, it should be overseen by the Government agency providing the money. There needs to be effective business cases developed to support applications for such funding assistance.
21. We would support any Local Government Resilience Fund being managed by a central government agency. It could perhaps be a function of the new drinking water regulator recently announced by government.

Case Study: Three Waters

22. Water New Zealand supports most of the findings and recommendations in this section but notes a couple of misunderstandings and strongly disagrees with one finding.
23. Section 9.2 notes that large economies of scale can be achieved from water, wastewater and storm water utilities but that this can result in local natural monopolies if there are no suppliers of non-reticulated water, such as bottled water. This comparison is irrelevant as it suggests that bottled water competes with reticulated water systems. Reticulated water

systems provide water for a range of household purposes including showering, cooking, toilet flushing and garden watering. It is estimated that only 3% of reticulated water is used for drinking water so bottled water is not an alternative for reticulated water. Reticulated water systems are natural monopolies, but bottled water supplies do not provide competition and are irrelevant to them. We suggest that the reference to bottled water is removed.

24. In section 9.3, under the section titled *Weak safety, environmental and economic regulation*, it is suggested that weak enforcement may be because the regulators are ill-equipped to deal with non-compliance with drinking water standards for reasons of affordability. The Health Act 1956, in section 69H (a) (ii) requires that regard is given to affordability when considering whether all practical steps have been taken, and taking all practical steps is required in relation to compliance with the drinking water standards. But a review of the Annual Report on Drinking Water Quality since 2007 when the Health (Drinking Water) Amendment Act was passed, shows that affordability has never been recorded as a reason for non-compliance with drinking water standards. Local authorities may raise concerns about the affordability of complying with drinking water standards, and supplying water in general, but they have never officially used it as a defence for standards non-compliance. So, the fact that regulators are ill-equipped to deal with non-compliance with drinking water standards for reasons of affordability is irrelevant to compliance. We suggest that this argument should be removed from the report.
25. The reason that compliance levels with the drinking water standards are poor and have not improved over the past 10 years is simply because the incumbent regulator has been incompetent in many aspects of regulation. The view of Water New Zealand is that there are a multitude of reasons for this situation, but a significant one is the inherent structural failure of the regulatory bodies which has the Ministry of Health contracting regulatory services to District Health Boards, organisations focused mainly on hospital and community health care.
26. Section 9.4 considers the need to establish an effective regulatory regime which is *tough on needing to meet minimum performance levels* and will *pursue significant financial penalties*. This approach reflects the combative and punitive drinking water regulatory approach taken in England where water suppliers are privatised. It seems curious that a report on the difficulties that local authorities face regarding funding and financing suggests that significant financial penalties would be a good thing for already struggling local authority water suppliers. Significant financial penalties would most likely remove funding which was intended to upgrade water supplies that fail compliance and exacerbate the water supply funding problem. It would in effect be self-defeating.
27. It is the view of Water New Zealand that improving compliance with drinking water standards is more likely to be achieved by taking the approach of European regulators in Denmark, the Netherlands and Germany, amongst others, where the regulators are collaborative but highly competent. These regulators have the expertise to assist water suppliers with understanding and achieving compliance but with punitive approaches reserved for the recalcitrant. A high level of regulator competence is the key to successful drinking water and wastewater regulation in those countries and is the approach preferred for New Zealand.
28. We are concerned that the report suggests that the Electricity Authority or Commerce Commission could be the drinking water regulator. It seems inconsistent that the report suggests a need for an organisation that *rigorously enforces minimum performance levels* but then highlights the Commerce Commissions *significant experience... with light handed*

regulation while suggesting the Commerce Commission would be a good drinking water regulator.

29. It is Water New Zealand's view that the report should not be making suggestions as to which organisation should be the drinking water regulator. The choice of organisation to be the drinking water regulator is not relevant to local authority funding and financing and would seem to be outside the scope of the report. For this reason, it is suggested that reference to which organisations could be the drinking water regulator should be removed from the report.
30. Water New Zealand disagrees with the proposed regulatory approach of being *tough on needing to meet minimum performance levels/permissive on how to lift performance*. It is questionable whether the report should be commenting on the regulatory approach a new drinking water regulator should take and it could be argued that this too is not within the scope of a report on Local Authority funding and financing.
31. It is also an approach that is difficult to regulate and carries considerable public health risks. The proposed approach seeks to set clear performance standards and then lets water suppliers determine how they will meet those standards. There seems to be an inference that New Zealand does not already have clear drinking water performance standards. This is not correct.
32. Clear drinking water performance standards have been set out in five successive versions of the New Zealand Drinking Water Standards since 1995. Maximum acceptable values (MAV), outlined in section two of the Drinking Water Standards for New Zealand 2005 (R2018) identify the maximum quantities of a range or parameters that are permitted in drinking water for compliance to be achieved. They are the same as the levels determined by the World Health Organisation and are used internationally.
33. Taking a permissive approach to how minimum performance levels are met presents a range of problems. It sounds like a good idea because it appears to place the burden of evidence that a water treatment system is effective onto the water supplier. If a water supplier chooses to use a particular system, then they must demonstrate that it will meet the minimum performance criteria.
34. In fact, such an approach places the burden of evidence onto the regulator and will consume considerable regulatory resources. If a water supplier chooses to install and use a particular system, makes claims and provides evidence to demonstrate that the system will meet minimum performance levels, the regulator then must scrutinise the evidence and assess those claims to verify whether they are true and correct and if the system will achieve the minimum performance criteria. The regulator will need considerable expertise and resources to do this.
35. The approach to drinking water standards promoted by the World Health Organisation and used in the United States, Australia, Canada and the European Union is to set MAVs and then outline which water treatment processes can be used and how those water treatment systems are required to demonstrate that the MAVs are achieved. It is prescriptive about the operational monitoring that must be undertaken to demonstrate that the systems are meeting necessary operational limits. It only allows the use of treatment systems and processes that have been demonstrated to be effective and are known to work. Based on international drinking water standards, this approach was adopted in New Zealand in 1995 and since then the bulk of the New Zealand drinking water standards have outlined how and what must be monitored to demonstrate that the systems are being operated

effectively. But the operational monitoring requirements are not the standard. The MAVs are the water quality standard.

36. This approach is universally accepted as required for a number of reasons. The first is that water treatment systems cannot be sites for experimenting or testing new ideas about water treatment. Risks to public health from inadequate or poorly functioning systems are well known and failures inevitably result in widespread illness and sometimes fatalities. It is a long-standing principle that only treatment systems that have been well tested and have known performance outcomes should be installed in drinking water supplies.
37. It is a cause for concern that the report is suggesting an approach that is untried in affluent western countries like New Zealand and is inconsistent with international best practice.
38. Promotion of a permissive approach to how councils meet performance levels or MAVs would allow them to purchase and install equipment that may not have been demonstrated to a credible authority to be as effective as is necessary. There is a risk that council decision-makers will be tempted by lower cost and heavy promotion of products to install equipment that puts public health at risk. They may choose to use equipment that is new and under development, insufficient to achieve the desired levels of performance, or that which cannot be demonstrated to consistently perform to the necessary standard. Performance monitoring programmes would need to be developed for each new piece of equipment and situation.
39. Such circumstances put the regulator in a very difficult position. The law would allow the water supplier to install the equipment they choose but the regulator, if unconvinced about the performance of the equipment, would have to use considerable expertise and resources to demonstrate that approach was not acceptable. These situations can become contested and litigious, if not being recipes for further public health disaster.
40. While some local government decision-makers may consider that a permissive approach gives them greater choice and an opportunity to reduce cost, water managers report to Water New Zealand that they prefer a prescriptive approach because it means everyone knows and is clear about what is required. They are not put into a position of assessing new and untested equipment and developing performance monitoring programmes. They prefer to install treatment systems that have been approved by the regulator and which have performance monitoring requirements that have been determined to meet the required treatment standards. Water supply managers do not want to be required to unnecessarily deal with uncertainty about public health risk. Use of tried and tested systems gives them greater certainty about the safety of the drinking water they supply.
41. Drinking water regulation is much simpler and less resource intense where treatment systems are approved known quantities, and operational performance measures are prescribed. For compliance assessments, the regulator only needs to determine if the treatment systems are approved and the necessary performance measures have been met.
42. This does not mean that new treatment systems cannot be developed and brought into service but should only occur after those systems have been adequately tested and determined by the regulator to perform to an acceptable standard. A good example of this is the introduction of UV disinfection systems. Prior to 2005 these systems were not permitted to be used on public water supplies because the manufacturers had not demonstrated their effectiveness. When that evidence was provided to the Ministry of Health, a change was made and the 2005 Drinking Water Standard allowed UV disinfection

as an acceptable water treatment process.

43. For the above reasons, Water New Zealand rejects the *rigorous/permissive* regulatory approach promoted and suggests that all references to it be removed from the report. In any case, it is Water New Zealand's view that comment on the approach that a drinking water regulator should take is inappropriate and out of scope for the report. Now that the Government has announced the establishment of a new drinking water regulator it would be our preference that they be left to decide on the approach they wish to adopt to enforcement of regulations.
44. Water New Zealand is willing to meet and discuss this submission with the Commission if that would assist the Inquiry.

Your sincerely

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